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SUBJECT: PARIS CLUB - JUNE 2006 TOUR D'HORIZON, 50 YEAR ANNIVERSARY,  
AND DEBT NEGOTIATIONS

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SUMMARY  
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¶1. (SBU) At the June 13-16 meeting of the Paris Club, creditors reached a tentative agreement on a deal that will allow Russia to repay its remaining USD 22 billion in previously rescheduled Paris Club debt in August. The deal is still subject to approval by Moscow. Cameroon received a completion point treatment under the Heavily Indebted Poor Countries (HIPC) initiative, which after further bilateral debt relief, will reduce its debt to Paris Club creditors from over 3.5 billion dollars to just 27 million dollars. The US, per its HIPC policy, agreed to cancel 100 per cent of its claims on Cameroon. Russia cast doubt on the prospects for a the first stage of a debt treatment for Afghanistan next month,

complaining that the debt reconciliation process still had not been completed and indicating that it was not prepared to negotiate at the July Paris Club meeting unless more progress has been made. Other countries on the agenda included Algeria, Angola, Argentina, Brazil, Congo-B, Djibouti, DRC, Iraq, Nigeria and Sudan. Creditors discussed the problems of litigating creditors (vulture funds) and free-riding (new lending to HIPCs). In addition, the Paris Club held its annual meeting with the private sector and hosted a conference to mark the club's 50th anniversary. END SUMMARY.

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AFGHANISTAN  
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¶2. (U) Russia said Afghanistan did not sign a data reconciliation agreement at a recent meeting between the two sides. Without agreement on the debt numbers, Russia is not prepared to negotiate the first stage of debt reduction (so-called "Naples treatment") in July. Russia asked the secretariat to send a letter to Afghanistan urging it to complete the reconciliation process. The US agreed that a letter would be useful and suggested that, despite the current impasse, Afghanistan be invited for negotiations in July, subject to approval of the PRGF and progress on reconciliation. Russia concurred.

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ALGERIA  
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¶3. (U) The Secretariat reviewed the status of Algeria's prepayment transaction. Participating creditors reported that they had either received payment in full or had arranged to be paid at a later date. Some creditors reported arrears but expect them to be cleared. The US received full prepayment of Ex-Im debt on June 15 (USD 627

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million). In a bilateral meeting on the margins of the Paris Club session, the Algerian finance minister informed the US delegation that the president of Algeria had written a letter to President Bush seeking prepayment of Algeria's debt to USDA (around USD 600 million). USDEL explained that the USDA debt did not contain prepayment provisions, and that the Paris Club agreement governing Algeria's prepayment prohibited early repayment above face value.

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ANGOLA  
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¶4. (U) Paris Club Chairman Musca's meeting with the Angolan Finance Minister, originally due to take place at the end of last month, is now scheduled for June 26. The IMF said Angola's new DSA will show that external debt indicators have improved substantially, resulting in the country's reclassification from high to moderate risk of debt distress.

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ARGENTINA  
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¶5. (U) The Secretariat asked if any creditors had met with Argentina bilaterally. Germany and the US reported that their embassies in Buenos Aires had been approached. Spain said President Kirchner will meet with Spanish authorities later this month, but it is unclear what his message will be. The US, supported by Italy and the Netherlands, stressed that creditors should continue to urge Argentina to pursue a multilateral solution in the Paris Club, and that any debt treatment without an IMF program would be problematic. Germany (Argentina's largest Paris Club creditor) said it was not looking to conclude a bilateral deal.

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BRAZIL  
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¶6. (U) The Secretariat took stock of Brazil's prepayment transaction. Italy and Canada reported some arrears that have yet to be cleared. Germany said it was trying to resolve some disputed claims. All other creditors have received prepayment and have no arrears. In response to a question from Italy, the Secretariat explained that Brazil has yet to make a formal request to become a member of the Paris Club, but appears to be considering such a request and has asked the Secretariat to gauge how creditors might

react.

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CAMEROON  
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¶17. (U) Creditors provided Cameroon its HIPC completion point treatment. In line with their commitment at decision point, creditors agreed to cancel USD 622 million in claims (in June 1999 NPV terms), including USD 117 million in interim relief already provided. An additional USD 3.1 billion will be canceled on a voluntary, bilateral basis.

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CONGO-BRAZZAVILLE  
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¶18. (U) The second phase of interim relief will enter into force upon approval of the second review of Congo-B's PRGF. The second review is scheduled for end-June. The US indicated that Congo needed to pay 779,638 dollars in arrears to Exim and USDA before it could support the extension of interim relief.

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DJIBOUTI  
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¶19. (U) Djibouti continues to run arrears to France and Spain. The Secretariat will send a letter to the authorities urging them to

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conclude a bilateral agreement with Spain implementing the 2000 Paris Club terms of reference, and noting that Djibouti could benefit from a Paris Club treatment if it had an IMF program in place. (The US is not a creditor.)

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DEMOCRATIC REPUBLIC OF CONGO  
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¶10. (U) The DRC's finance minister has requested a meeting with the Secretariat to examine ways for creditors to extend interim HIPC

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relief, despite the fact that the DRC's PRGF has expired and a successor arrangement is uncertain. The Secretariat will deliver a three-pronged message: (1) creditors cannot extend interim relief in the absence of an IMF program; (2) creditors are pleased with the DRC's willingness to be cooperative; and (3) the DRC should respect inter-creditor equity.

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IRAQ  
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¶11. (U) Russia and Ireland are the only remaining Paris Club creditors that have yet to sign a bilateral agreement with Iraq. Russia expressed optimism that a meeting with the Iraqi Finance Minister scheduled for later in the week could result in progress on data reconciliation. The Secretariat reported that discussions between Ireland and Iraq were progressing, and that a bilateral should be signed soon.

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NIGERIA  
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¶12. (U) Amid press reports that Nigeria is considering a restructuring of its commercial debt, the Secretariat expressed concern that participants at the Paris Club's annual meeting with the private sector might question whether the comparability of treatment principle is being respected. The UK, supported by the US, reminded creditors that they had already determined last year that Nigeria's previous commercial restructurings were sufficient to satisfy the comparability of treatment requirement. Moreover, since Nigeria no longer had any Paris Club debt, it was pointless for the Club to reopen the debate. The following day, at the meeting with the private sector, private sector participants did not press the issue.

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RUSSIA

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¶13. (SBU) Creditors agreed to the terms of a transaction that will allow Russia to pay off the totality of its previously rescheduled Paris Club debt. The agreement was not finalized, however, because Russia said the envisaged payments exceeded a limit established by its Council of Ministers. Russia will seek approval from the council later this month. If the council consents, the agreement will take effect. The agreement came at the end of protracted and bitter negotiations that extended over two days. For its opening position, Russia offered to prepay its remaining Paris Club debt at face value, in line with the USD 15 billion prepayment transaction that was concluded last summer. Germany and France, who together account for over half of the USD 22 billion in debt outstanding, declined the offer. Both countries indicated that they would not include all their claims in a prepayment at face value, but would consider participating fully in a buyback at market value. Russia's negotiating strategy was then to find a sufficient price to entice Germany and France to participate, while minimizing the premium paid to other creditors who were otherwise prepared to accept face value.

In the agreement that emerged, Germany, France, the Netherlands, the UK were the only countries eligible to receive a premium above face value for their fixed-rate claims. The US did not sign the Agreed Minute, but provided a side letter welcoming the agreement and reiterating that Russia has the contractual right to prepay its outstanding US debt at any time. The negotiations with Russia contrasted sharply with those that took place with Algeria last month. In the case of Algeria, the Secretariat quickly quashed discussion of a buyback option at market value, arguing that Algeria would never consider it. In the case of Russia, the Secretariat was

prepared to bend Paris Club principles to meet two objectives: (1) close a deal in which all creditors participated; and (2) ensure that France and Germany received market value for their fixed-rate claims, even if others did not.

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SUDAN  
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¶14. (U) At the request of the Netherlands, the Secretariat agreed to initiate a data call, under which creditors will report the amount of Sudan's bilateral debt.

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Litigating Creditors  
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¶15. (U) Reacting to the Secretariat's working paper on ways for the Paris Club to help debtor countries defend themselves from litigating creditors (sometimes referred to as "vulture funds"), the US, Spain, and the UK stressed the importance of respecting the rule of law. The US added that amicus briefs were not likely to be effective, and that the status quo was perhaps the best option. Spain, Italy, and the UK said changes to domestic laws would be difficult. In response to Spain's comment that the issue of litigating creditors was one for the IFIs to resolve, the IMF said there was little it could do other than try to exert moral suasion. Both the IMF and the US raised a related question that will require further thought: how does the Paris Club deal with debtors who negotiate settlements with private creditors that are clearly not consistent with comparability of treatment? The Secretariat concluded by saying that this discussion was a first step in an effort to find a common approach to the issue. At the next meeting, it will ask creditors to consider concrete steps that can be taken immediately, such as sending letters to debtors on the comparability of treatment requirement that they can use in their discussions with litigating creditors. The Secretariat thought a meeting with litigating creditors, as suggested by the US, would be useful, but that Paris Club creditors first need to decide on a common message.

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Free-Riding  
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¶16. (U) The Secretariat gave a comprehensive and useful presentation on free-riding, i.e. the problem of emerging creditors, such as China, providing non-concessional debt or excessive amounts of concessional debt to heavily indebted countries or countries that have just completed the HIPC process. The presentation highlighted efforts underway in the IMF, World Bank, and OECD to address free-riding and suggested a number of (mostly constructive) steps

the Paris Club could take to help, namely:

- Promote the use of the IMF's Debt Sustainability Framework (DSF) to inform lending decisions
- Exchange views and data on free-riding cases
- Inform countries that have not completed the HIPC process that the Paris Club will insist that they seek comparable debt relief from new lenders
- Ask HIPC countries to make commitments on responsible borrowing.  
(It is unclear how this would work in practice, or whether the Paris Club should be the arbiter of responsible borrowing.)

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Annual Meeting with the Private Sector  
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¶17. (U) Participants discussed recent Paris Club activity (including agreements concluded with Nigeria and Algeria), developments in emerging debt markets, Iraq's commercial debt restructuring, and Argentina's debt situation. The Institute of International Finance (IIF) touted its Principles for stable capital flows and fair debt restructuring in emerging markets, claiming that debtor countries were implementing the Principles more than ever. On the issue of comparability of treatment, the IIF questioned why the Paris Club isn't more transparent in instances where comparable treatment is judged to have been satisfied by previous commercial restructurings (e.g., case of Moldova and Nigeria). Paris Club chairman Musca said the Club would give the issue more thought, but in the meantime, the private sector can always check with the debtor country to see if comparable treatment has been satisfied.

¶18. (U) French Bank UBAF, which led the so-called London Club Consultative Group, launched into a blistering and at times ad hominem attack on Iraq's advisors and their "unilateral" commercial offer - even though UBAF accepted the offer. The US pointed out that the Iraqi authorities and their advisors had very different views, but were not in the room to defend themselves. Musca said the Paris Club has done its best to emphasize the importance of transparency, cooperation, and equitable treatment in debt restructurings, but can't be expected to act alone. He called on the IMF and other international actors to ensure that the Principles, the IMF's lending-into-arrears policy, and other standards were respected.

¶19. (U) In his presentation on Argentina, Nicola Stock, representing Italian bondholders, remarked that a country that could repay its debts to the IMF should have treated its private creditors better. A representative from the Argentine Bondholders Committee said reverse comparable treatment should apply (i.e., the Paris Club

should provide debt relief equivalent to that already provided by the private sector), and called on the Paris Club not to restructure Argentina's debt without an IMF program. The Secretariat confirmed that an IMF program was a prerequisite for a restructuring in the Paris Club, which in turn would require that Argentina be in compliance with the Fund's lending-into-arrears policy (i.e., the policy of lending only when the debtor is making a good faith effort to reach an agreement with creditors). The IMF said it did not see any prospect for an IMF program with Argentina at this time, and noted that it was planning to review its lending-into-arrears policy. The IIF said any revision to the lending-into-arrears policy must not facilitate misbehavior by debtor countries.

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50th Anniversary Conference  
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¶20. (U) The conference was organized around two roundtable discussions: (1) the Paris Club and the international financial architecture, and (2) the Paris Club and the restoration of debt sustainability. During the first discussion, Jacques de Larosiere (IIF) touched on a number of familiar themes, including the shift from sovereign lending to private capital, the "take-it-or-leave-it" debt restructuring offers by Iraq and Argentina, the failure of the Paris Club to recognize reverse comparable treatment, and the IMF's reluctance to enforce its own lending-into-arrears policy. Jean Lemierre (EBRD and former Paris Club Chairman) defended one-way comparability of treatment, arguing that sovereign lenders and private lenders were fundamentally different. Several speakers said

the credibility and relevance of the Paris Club depended on the Club's success in reaching out to emerging lenders. Others expressed support for the IIF Principles and called for increased transparency and cooperation with the private sector. In the second roundtable, Michel Camdessus, former IMF Managing Director and Chairman of the Paris Club, highlighted the risk that irresponsible borrowing in low-income countries could lead to new debt crises. Nigerian Finance Minister Ngozi Okonjo-Iweala suggested that the Paris Club should take into account debtor countries' development needs in determining the level of sustainable debt, while debtors need to monitor their own borrowing. Vincenzo La Via (World Bank) said debt cancellation itself would not ensure debt sustainability and emphasized the importance of the DSF and governance issues. Overall, speakers in both sessions were reluctant to engage in a serious debate about the Paris Club's future, opting instead to pose broad, rhetorical questions interspersed with paeans to the Club's history and accomplishments.

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